# Coventry Building Society

## Interim Financial Report
## for the period ended 30 June 2013

# Contents



## IFRS RESULTS

This Interim Financial Report for the six months ended 30 June 2013 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with IAS 34 Interim Financial Reporting as adopted by the EU. The Interim Financial Report should be read in conjunction with the Annual Report & Accounts for the year ended 31 December 2012, which have been prepared in accordance with IFRS as adopted by the EU.

## FORWARD LOOKING STATEMENTS

Certain statements in this Interim Financial Report are forward looking. The Society, defined in this Interim Financial Report as Coventry Building Society and its subsidiary undertakings, believes that the expectations reflected in these forward looking statements are reasonable based on the information available at the time of the approval of this report. However, we can give no assurance that these expectations will prove to be an accurate reflection of actual results. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward looking statements. We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.

## HIGHLIGHTS

The directors are pleased to present the results for the six months ended 30 June 2013.

### Increasing share of the mortgage and savings markets

- New mortgage lending up 16% to £2.9 billion (30 June 2012: £2.5 billion).
- Net mortgage lending was £1.2 billion, equivalent to 47% of all net mortgage lending in the UK[1].
- Savings balances increased by £821 million, to a record £20.9 billion.

### Continued strong financial performance

- Profit before tax increased by 18% to £62.2 million (30 June 2012: £52.8 million).
- Growth in profitability achieved notwithstanding significant increase made to the rate paid to all variable, easy access existing ISA savers[2].
- Cost to mean asset ratio was 0.38%, the lowest reported by a UK building society.
- Impairment charges just £3.5 million from a loan book of £23.2 billion, reflecting the Society's low risk lending both before and throughout the credit crisis.
- Loans where arrears were greater than 2.5% of the balance was 0.70% (including possessions). This represents just 42% of the industry average of 1.65%[3].
- Core tier 1 ratio of 22.5% remains the highest reported by any top 10 building society or mutual lender.
- Maintained strong 'A' credit ratings throughout the 'credit crunch' – Fitch (A) and Moody's (A3).

### Doing the right thing for members and the community

- Average savings rate of 2.55% - Coventry has reported the highest average savings rates[4] to its members of any top 10 building society or mutual over the last six years.
- The minimum rate for all variable, easy access existing ISA savers[2] increased to a market leading[5] 2.50% tax-free p.a./AER[6] on 6 April 2013.
- Over 90% of savings balances currently held at the Society are paid a rate equal to or higher than the equivalent 'best buy' from any major high street bank or building society[7].
- In the most recent table published by the Financial Ombudsman Service, Coventry had the lowest proportion of complaints upheld of any high street bank or building society listed.
- No individual member of staff is incentivised to sell products and hasn't been since 2010.
- £8.5 million raised for the Royal British Legion's Poppy Appeal since October 2008.
- New partnership with Cancer Research UK builds on the Society's innovative support for the charitable sector. The first Race for Life Bond was launched in June 2013, and is expected to raise over £200k for this good cause.

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1. Source: BSA.
2. All variable, easy access ISA balances at 6 April 2013.
3. Source: PRA (31 March 2013).
4. Average rate estimate based upon interest payable on shares divided by average of opening and closing shares balances, as disclosed in Financial Statements.
5. Based on Moneyfacts data as at 30 June 2013.
6. Annual Equivalent Rate.
7. Compared to high street banks and building societies (ISA: based on a balance of £5,670, Junior ISA: £3,720, Fixed Rate Bond: £25,000, Easy Access: £10,000, Current/MoneyManager and Children's Accounts: £1) excluding those with restricted availability (e.g. existing customers only, Sharia or reliant on maintaining or opening another product with the same provider). Source Moneyfacts Data as at 30 June 2013.

**INTERIM MANAGEMENT REPORT: CHIEF EXECUTIVE'S REVIEW**

Coventry has maintained its track record of strong performance which was established before the onset of the current financial crisis in late 2007.

As a mutual building society, we run the Society in the interests of members. Whilst this requires us to remain strongly profitable, the need to protect savers in a difficult market has been a particular priority, alongside providing a consistent and responsible level of mortgage finance to homeowners. These priorities can be seen in the further growth of both savings and mortgage balances.

Coventry's consistent performance is based on strong fundamentals. We remain the most cost-efficient building society in the UK, the quality of our lending is exemplary, and our core tier 1 capital ratios show us to be amongst the strongest of UK financial institutions. We have retained our 'A' rating from the two main credit rating agencies that rate the building society sector, and have developed a sustainable business that has the fair treatment of customers at its heart.

Although these achievements may not be guaranteed by a mutual business model, Coventry continues to demonstrate that building societies can thrive in the toughest of environments.

**Continued support of the mortgage market**

Gross mortgage advances totalled £2.9 billion, a record for the Society in terms of both value and market share.

Mortgage balances increased by £1.2 billion, a performance in contrast to that of the market as a whole. Coventry now accounts for 25% of mortgage growth in the UK since the start of 2010[1].

Whilst the Funding for Lending Scheme ('FLS') has successfully helped underpin the supply of mortgages, it is still the case that since the scheme was launched, major lenders collectively have reported a significant contraction in mortgage lending.

The latest figures published by the Bank of England show that in the first 9 months of the scheme, to 31 March 2013, the 10 largest participating lenders had recorded negative aggregate net lending of over £8.6 billion (excluding Coventry). Coventry's positive net lending over the same period of £1.6 billion emphasises the Society's continuing financial strength and the extent to which its business model has been relatively unaffected by the events of the past few years.

**Protecting savers**

The challenges facing savers are, in some ways, unprecedented. The Bank of England Base Rate has been unchanged at its historical low of 0.50% since March 2009, and significant further cuts in market savings rates have been evident since the launch of FLS. These reductions have impacted both new and existing savers.

In this difficult environment for savers, we have sought to pay all Coventry members very competitive rates on their savings.

In April, we took a unique decision amongst high street banks and building societies to increase the interest rate to 2.50% on a quarter of a million existing cash ISA accounts. As a result, the average interest rate earned by Coventry ISA savers is around 2.70% (as at 30 June 2013).

In fact, well over 90% of all Coventry savings balances – both ISA and non-ISA accounts – currently earn a rate of interest that is equal to or higher than the equivalent best buy available from any major high street bank or building society[7]. The average rate paid to savers during the first half of 2013 was 2.55%[4].

None of our savings products are restricted just to new customers allowing existing members to open new accounts as they are made available. Notwithstanding the availability of cheaper funding through the FLS, offering competitive savings products remains an important objective.

This can be seen in the number of 'best buy' products we have made available. Coventry has provided a market leading ISA for over 60 weeks, our Junior ISA has been joint best buy since its first launch in April 2012, whilst we have also offered leading rates for easy access accounts and fixed rate bonds this year[7].

Not surprisingly, such strong offerings attracted significant retail savings inflows and savings balances increased by £821 million, to £20.9 billion.

**Strong and growing profits**

In electing to increase the rates paid to long-standing ISA savers, and in maintaining rates on other savings accounts at higher than equivalent best buys, we have chosen to restrict profits below that which could otherwise have been reported.

Nevertheless, net interest income increased by £14.2 million (15%), reflecting amongst other things the benefit of growth in earlier years as well as lower funding costs available via the Funding for Lending Scheme. As at 30 June 2013, the Society had drawn down £500 million from FLS.

The quality of our lending is demonstrated in impairment charges that remain very much lower than for the industry as a whole. Impairment charges totalled £3.5 million, just 0.02% of a loan book which totals £23.2 billion.

The care we exercise in our lending decisions is reflected equally in our control of costs. With a cost to mean assets ratio of 0.38%, Coventry is the UK's most cost-efficient building society. The cost to income ratio of 44.1% also benchmarks favourably with both banking and building society competitors notwithstanding the relatively high rates paid to savers, and the low risk nature of our lending.

Improved income, low costs and low impairment charges combined to produce profit before tax of £62.2 million, an increase of 18% over the first half of 2012.

**Committed to fair treatment**

The importance of treating customers fairly continues to be emphasised in the media, by regulators and by consumer associations.

For example, the issue of the past mis-selling of Payment Protection Insurance (PPI) is a constant reminder that profit must not be sought at the expense of the right consumer outcome. The increased public awareness of this issue, and the associated activities of claim management companies, has led to a large increase in complaints on this matter across the market as a whole. This has included a number of speculative complaints. By way of example, 63% of the PPI complaints we have received are from people that have never bought such a policy from the Society.

Whilst overall complaints have increased as the result of such activity, FCA reportable complaints relating to our core savings, mortgage and transactional activities reduced in the first half of 2013.

Of the relatively few complaints that are referred to the Financial Ombudsman Service ('FOS'), an extremely low number are reviewed in favour of the customer reflecting the Society's aim to put things right when mistakes are made. Whilst tables for the first half of 2013 have yet to be published, we are confident that we will maintain the Society's excellent record in this area. Indeed, in the most recent table published by FOS, Coventry had the lowest proportion of complaints upheld of any high street bank or building society listed.

**Supporting the communities in which we work**

Our work in the community and our support of charities and other good causes remains integral to our business. Through the enthusiasm of our staff we have extended the support we offer schools and colleges, improving essential skills and developing financial awareness as well as enhancing career prospects. Branch and head office teams volunteer with over 50 community partners, raising funds and awareness for what are often small local charities that make a big contribution to their communities.

In recent years, we have also become known for our support of charities through the provision of affinity savings accounts. In June, we were delighted to launch the first Race for Life Bond in partnership with Cancer Research UK. This is based on the very successful approach pioneered with The Royal British Legion which has already resulted in donations of £8.5 million to the Poppy Appeal since 2008. We will continue to support the Appeal in the future, having confirmed the Legion as our corporate charity.

**Strong and secure**

In order to compete in the market for new mortgages and savings, to pay the highest interest rates to savers, and to support charities, the Society must be financially strong.

Coventry is one of the most highly rated banks or building societies in the UK, being 'A' rated by both Fitch (A) and Moody's (A3). In fact, Coventry is now the only major high street bank or building society not to have been downgraded by either of these agencies over the last four years.

At 22.5%, the Society's core tier 1 ratio remains the highest reported by any top 10 building society or mutual lender whilst over the last five years our impairment charges have been covered over seven times by our pre-impairment profits. Since 1 January 2011 the coverage of impairment by pre-impairment profits has been over 10 times. This is comfortably the highest coverage in our peer group[8], evidencing the very high quality of our assets.

The need to factor emerging capital requirements into our thinking, most notably the implementation of simple, backstop leverage ratios, has been incorporated into our plans. The Society's leverage ratio as at the 30 June 2013 was 3.2% under Basel III, applying first year transitional provisions.

**Outlook**

Although some encouraging signs have been reported, the economic environment remains uncertain.

In such times, it is very important for customers to be confident in their choice of financial services provider. As a minimum, it should provide security, long-term value, and fair and efficient treatment.

The last few years have been amongst the most successful in the Society's history, as its ability to deliver these requirements has been increasingly recognised.

I believe that Coventry Building Society remains in an excellent position, not only to justify the confidence of existing members, but to continue to grow and attract new ones.

Signed on behalf of the Board by

David Stewart
Chief Executive
1 August 2013

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8. Top 10 building society or mutual lender.

**PRINCIPAL RISKS AND UNCERTAINTIES**

The Disclosure and Transparency Rules (DTR 4.2.7R) require that a description of the principal risks and uncertainties are given in the Interim Financial Report for the remaining six months of the financial year.

The principal risks and uncertainties affecting the Society were reported on page 26 of the Annual Report & Accounts as at 31 December 2012. These risks are defined as credit, market, liquidity and operational risk, which are common to most financial services firms in the UK. These risks continue to affect the Society as at 30 June 2013, and there have been no material changes to the Society's approach to risk management during the first half of the year.

Although the global economic environment remains subdued, there have been tentative signs of improvement in the UK housing market and economy as a whole. Not surprisingly the key themes of the risk environment remain consistent with those assessed in 2012:

- Depressed domestic economic conditions, albeit with some recent signs of improvement
- Depressed Eurozone conditions, with high levels of unemployment
- Continued operational and cultural issues within banks
- Regulatory reforms

These risks and uncertainties and how the Society is mitigating them are summarised below:

*Depressed economic conditions, albeit with some recent signs of improvement*
The much speculated near triple dip recession was ultimately shown to not even have been a double dip, with signs that the housing market and wider economy are starting to improve. However, the feeling has been tempered by fears that the comparatively cheap funding available to lenders via the Funding for Lending Scheme (FLS), together with Government-backed schemes to support homebuyers (*e.g.* Help to Buy), could lead to another housing bubble. Moreover, the Government's desire for more lending to reach households could create credit risks for lenders that undertake lending at higher LTVs.

In its assessment of the economic environment, the Society has always taken a prudent approach to anticipated rate rises. Even against a prolonged projected flat base rate assessment, the Society continues to generate strong profits with no diminution of capital. The Society is conscious of the inherent risks to mortgage customers currently enjoying relatively low rates who could suffer from rate 'shock' in the event that Bank Base Rate begins to rise. To this end, the Society only lends to those customers who it believes can afford repayments even at higher rates and adopts a supportive approach to those few that do experience difficulties. The Society also continues to ensure that it has a significant proportion of administered rate savings and mortgages giving it greater flexibility than many of its peers to manage these risks.

The ability to administer such a large proportion of both the mortgage and savings book also provides management with a number of credible options in the event of an upward or downward movement in Base Rate. The fact that the Society's Standard Variable Rate remains at the lower end of its peer group[7], better positions our members for any such rate rises.

Credit risk associated with the Society's mortgage book remains very low as evidenced by some of the lowest arrears rates in the industry. The credit risks faced by the Society are further mitigated by the low indexed LTV of the mortgage book, which stands at just 51%.

*Depressed Eurozone conditions with high levels of unemployment*
Speculation of a Eurozone fall-out has settled although the spectre remains, with the prevalence of record unemployment rates, weakened GDP, and little sign of sustainable recovery; the OECD has revised its forecast of the Eurozone to a 0.6% contraction in 2013, with unemployment rising to 12%. While many UK firms have reduced their exposure to the Eurozone, there remains a threat from residual redenomination risk, credit risk or wider economic impacts.

Redenomination risk is the risk that in the event that the Euro ceases to trade, previously matched foreign exchange positions, designated in Euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent). Redenomination risk is therefore a form of foreign currency related market risk.

The Society has very little redenomination risk with all euro denominated exposure held in highly rated UK, Dutch or German counterparties, the predominance being UK entities. There is no direct credit risk from any eurozone sovereign as the Society does not hold any sovereign securities other than those of the UK and supranational institutions, and the Society continues to take a very cautious view towards exposure to European counterparts. The Society's analysis of counterparty risk extends to the risk from bail-in as well as to credit default events.

*Continued operational and cultural issues within banks*

The operational events which characterised 2012 for a number of the larger UK based banks have shown no signs of an end in 2013. Added to this, intense political and media interest in banking culture has led to further proposals for regulatory reform and a continued low level of trust in the banking sector by consumers.

With regard to the highest profile events the Society is not a market maker and therefore has no means or incentive to modify market rates such as LIBOR and does not therefore have exposure to the reputational risk impacts seen in some of the UK banks. The risks arising from mergers and acquisitions, which have highlighted the fragility of some firms, have been shown to be well managed by the Society as illustrated by previous successful integrations and are not a key feature of the business model.

The damage associated with a loss of consumer trust is exemplified by the high level of complaints amongst many financial services providers for specific issues, including mis-selling, or poor service. In contrast the Society has an excellent track record of reporting low numbers of complaints and resolving those complaints it does receive to the satisfaction of the member concerned. This is the case with complaints reported to the regulator and the Financial Ombudsman Service. Complaints will remain an important measure of the Society's performance in managing conduct risk as well as customer satisfaction.

*Regulatory reforms*

The agenda of regulatory reform continues to be congested. The Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD), together the CRD IV package, was released in its final form in June and will come into force on 1 January 2014.

Some elements of the CRD IV package remain under local regulators' jurisdiction until proposals are finalised at European level. In particular, there remains a degree of uncertainty around the basis on which the leverage ratio will be calculated and the floor at which it will be set. Adopting the calculation as set out in the Basel III/CRD IV text and applying the first year of transitional provisions, results in a ratio of 3.2%.

The transition from the current capital adequacy regime to the CRD IV package is being assessed through regular monitoring of the European Banking Authority's technical standards. The Society ensures that its focus on regulatory matters is appropriately split between prudential and conduct matters, thus aligning with the 'twin peaks' structure which came into force on 1 April 2013.

A key focus of the conduct team is regulatory reforms relating to the mortgage market (Mortgage Market Review – 'MMR'), which has the potential to significantly alter the manner in which lenders and intermediaries interact with their customers. However, the Society believes it is well placed to meet the full regulatory timescale for MMR and does not believe that the reforms will have an adverse impact on its business model or strategy.

Further information on the Society's approach to risk management can be found on page 25 of the Annual Report & Accounts as at 31 December 2012.

## CONDENSED CONSOLIDATED INCOME STATEMENT
## FOR THE PERIOD ENDED 30 JUNE 2013

| | Notes | Period to 30 June 2013 (Unaudited) £m | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|---|
| Interest receivable and similar income | 3 | **424.0** | 435.4 | 846.5 |
| Interest payable and similar charges | 4 | **(312.1)** | (337.7) | (659.6) |
| Net interest income | | **111.9** | 97.7 | 186.9 |
| Fees and commissions receivable | | **6.3** | 7.4 | 14.6 |
| Fees and commissions payable | | **(1.6)** | (1.8) | (3.6) |
| Other operating income | | **0.3** | 1.2 | 1.5 |
| Net gains from derivative financial instruments | | **4.1** | 0.7 | 0.1 |
| Total income | | **121.0** | 105.2 | 199.5 |
| Administrative expenses | 5 | **(48.3)** | (42.3) | (89.0) |
| Amortisation of intangible assets | | **(2.1)** | (1.8) | (3.8) |
| Depreciation of tangible fixed assets | | **(3.0)** | (2.9) | (5.8) |
| Operating profit before impairments and exceptional items | | **67.6** | 58.2 | 100.9 |
| Impairment losses on loans and advances to customers | 6 | **(3.5)** | (4.3) | (9.6) |
| Provisions for liabilities and charges | 7 | **(0.9)** | - | - |
| Operating profit after impairments and before exceptional items | | **63.2** | 53.9 | 91.3 |
| Provision for FSCS levies | 7 | **-** | - | (10.2) |
| Gain on pension curtailment | | **-** | - | 9.3 |
| Operating profit after impairments and exceptional items | | **63.2** | 53.9 | 90.4 |
| Charitable donation to Poppy Appeal | | **(1.0)** | (1.1) | (1.9) |
| Profit before tax | | **62.2** | 52.8 | 88.5 |
| Taxation | | **(14.5)** | (13.0) | (21.0) |
| **Profit for the financial period** | | **47.7** | 39.8 | 67.5 |

Profit for the financial period arises from continuing operations and is attributable to the members of the Society.

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
## FOR THE PERIOD ENDED 30 JUNE 2013

| | Notes | Period to 30 June 2013 (Unaudited) £m | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|---|
| **Profit for the financial period** | | **47.7** | 39.8 | 67.5 |
| **Other comprehensive income** | | | | |
| **Items that will not be transferred to the income statement:** | | | | |
| Remeasurement of defined benefit plan | | **-** | - | (5.0) |
| Taxation | | **-** | - | 1.0 |
| Effect of tax rate change on other items through the general reserve | | **-** | (0.1) | - |
| **Items that may subsequently be transferred to the income statement:** | | | | |
| Available-for-sale investments: | | | | |
| Fair value movements taken to reserves | 13 | **(73.6)** | 39.4 | 34.5 |
| Amount transferred to income statement | 13 | **73.3** | (28.0) | (41.2) |
| Taxation | | **0.1** | (2.8) | 0.8 |
| Cash flow hedges: | | | | |
| Fair value movements taken to reserves | 14 | **(1.7)** | - | - |
| Amount transferred to income statement | 14 | **1.2** | - | - |
| Taxation | | **0.1** | - | - |
| **Other comprehensive income for the period, net of tax** | | **(0.6)** | 8.5 | (9.9) |
| **Total comprehensive income for the period, net of tax** | | **47.1** | 48.3 | 57.6 |

The notes on pages 13 to 21 form part of this Interim Financial Report.

## CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION
## AS AT 30 JUNE 2013

| | Notes | 30 June 2013 (Unaudited) £m | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash in hand and balances with the Bank of England | | **2,639.6** | 1,399.9 | 1,814.2 |
| Loans and advances to credit institutions | | **339.8** | 434.0 | 323.7 |
| Debt securities | 8 | **2,164.0** | 2,682.5 | 2,338.2 |
| | | **5,143.4** | 4,516.4 | 4,476.1 |
| Loans and advances to customers | 9 | **23,172.3** | 21,035.4 | 22,018.9 |
| Hedge accounting adjustment | | **33.0** | 80.1 | 86.8 |
| Derivative financial instruments | | **222.4** | 249.6 | 279.6 |
| Intangible assets | | **9.8** | 9.1 | 9.2 |
| Property, plant and equipment | | **30.2** | 31.1 | 30.5 |
| Investment properties | | **5.3** | 5.3 | 5.4 |
| Pension benefit surplus | | **15.1** | 5.2 | 10.1 |
| Deferred tax assets | | **8.4** | 10.3 | 9.1 |
| Prepayments and accrued income | | **10.0** | 8.8 | 8.1 |
| **Total assets** | | **28,649.9** | 25,951.3 | 26,933.8 |
| | | | | |
| **Liabilities** | | | | |
| Shares | 10 | **20,931.8** | 19,271.2 | 20,110.5 |
| Deposits from banks | | **1,929.5** | 822.9 | 715.9 |
| Other deposits | | **6.0** | 10.5 | 9.5 |
| Amounts owed to other customers | | **464.9** | 468.8 | 450.0 |
| Debt securities in issue | | **3,739.4** | 3,647.5 | 3,874.7 |
| Hedge accounting adjustment | | **150.7** | 226.0 | 240.4 |
| Derivative financial instruments | | **269.5** | 399.1 | 411.2 |
| Current tax liabilities | | **12.9** | 12.2 | 3.8 |
| Deferred tax liabilities | | **4.6** | 2.9 | 3.7 |
| Accruals and deferred income | | **39.9** | 50.0 | 48.0 |
| Other liabilities | | **8.7** | 8.9 | 21.7 |
| Provisions for liabilities and charges | 7 | **23.6** | 19.4 | 23.1 |
| Subordinated liabilities | 11 | **58.1** | 58.1 | 58.1 |
| Subscribed capital | 12 | **161.4** | 161.3 | 161.4 |
| **Total liabilities** | | **27,801.0** | 25,158.8 | 26,132.0 |
| | | | | |
| **Equity** | | | | |
| General reserve | | **859.1** | 787.6 | 811.4 |
| Available-for-sale reserve | 13 | **(9.8)** | 4.9 | (9.6) |
| Hedging reserve | 14 | **(0.4)** | - | - |
| **Total liabilities and equity** | | **28,649.9** | 25,951.3 | 26,933.8 |

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' INTERESTS
## FOR THE PERIOD ENDED 30 JUNE 2013

| | General reserve £m | Available-for-sale reserve £m | Hedging Reserve £m | Total £m |
|---|---|---|---|---|
| **As at 1 January 2013 (Audited)** | **811.4** | **(9.6)** | **-** | **801.8** |
| Profit for the financial period | **47.7** | **-** | **-** | **47.7** |
| Net movement in Available-for-sale reserve (net of tax) | **-** | **(0.2)** | **-** | **(0.2)** |
| Net movement in Hedging reserve (net of tax) | **-** | **-** | **(0.4)** | **(0.4)** |
| **As at 30 June 2013 (Unaudited)** | **859.1** | **(9.8)** | **(0.4)** | **848.9** |

| | General reserve £m | Available-for-sale reserve £m | Hedging Reserve £m | Total £m |
|---|---|---|---|---|
| As at 1 January 2012 (Audited) | 747.9 | (3.7) | - | 744.2 |
| Profit for the financial period | 39.8 | - | - | 39.8 |
| Effect of tax rate change on other items through the general reserve | (0.1) | - | - | (0.1) |
| Net movement in Available-for-sale reserve (net of tax) | - | 8.6 | - | 8.6 |
| As at 30 June 2012 (Unaudited) | 787.6 | 4.9 | - | 792.5 |

| | General reserve £m | Available-for-sale reserve £m | Hedging Reserve £m | Total £m |
|---|---|---|---|---|
| As at 1 January 2012 (Audited) | 747.9 | (3.7) | - | 744.2 |
| Profit for the financial year | 67.5 | - | - | 67.5 |
| Remeasurement of defined benefit plan (net of tax) | (4.0) | - | - | (4.0) |
| Net movement in Available-for-sale reserve (net of tax) | - | (5.9) | - | (5.9) |
| As at 31 December 2012 (Audited) | 811.4 | (9.6) | - | 801.8 |

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
## FOR THE PERIOD ENDED 30 JUNE 2013

| | **Period to 30 June 2013 (Unaudited) £m** | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before tax | **62.2** | 52.8 | 88.5 |
| Adjustments for: | | | |
| Impairment provisions | **3.5** | 4.3 | 9.6 |
| Other provisions | **0.9** | - | - |
| Depreciation and amortisation | **5.1** | 4.7 | 9.6 |
| Interest on subordinated liabilities | **2.1** | 2.5 | 4.6 |
| Interest on subscribed capital | **6.1** | 6.1 | 12.2 |
| (Increase)/decrease in fair value adjustment of hedged risk | **(47.1)** | (1.9) | 34.9 |
| Other non-cash movements | **42.7** | (12.2) | 1.7 |
| **Non-cash items included in profit before tax** | **13.3** | 3.5 | 72.6 |
| | | | |
| Decrease/(increase) in loans to credit institutions and other liquid assets | **1.0** | (1.1) | (243.7) |
| Increase in loans and advances to customers | **(1,156.9)** | (1,799.7) | (2,788.5) |
| (Increase)/decrease in prepayments, accrued income and other assets | **(7.3)** | 22.3 | (9.5) |
| **Changes in operating assets** | **(1,163.2)** | (1,778.5) | (3,041.7) |
| | | | |
| Increase in shares | **769.7** | 260.2 | 1,148.2 |
| Increase in deposits and other borrowings | **1,225.6** | 219.7 | 93.0 |
| Increase/(decrease) in debt securities in issue | **6.3** | 5.7 | (126.1) |
| (Decrease)/increase in accruals, deferred income and other liabilities | **(21.5)** | 105.4 | 26.4 |
| **Changes in operating liabilities** | **1,980.1** | 591.0 | 1,141.5 |
| | | | |
| Interest paid on subordinated liabilities | **(2.1)** | (2.6) | (4.6) |
| Interest paid on subscribed capital | **(6.1)** | (6.1) | (12.2) |
| Taxation | **(3.6)** | (4.7) | (14.4) |
| **Net cash flows from operating activities** | **880.6** | (1,144.6) | (1,770.3) |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of investment securities | **(482.7)** | (2,313.9) | (3,104.3) |
| Sale and maturity of investment securities | **587.0** | 2,514.6 | 3,645.6 |
| Sale of properties | **-** | 3.6 | 3.6 |
| Purchase of property, plant and equipment | **(2.7)** | (1.1) | (3.7) |
| Purchase of intangible fixed assets | **(3.1)** | (1.4) | (3.5) |
| **Net cash flows from investing activities** | **98.5** | 201.8 | 537.7 |
| | | | |
| **Cash flows from financing activities** | | | |
| Repurchase of subordinated liabilities | **-** | (10.0) | (10.0) |
| Maturity and repayment of debt securities | **(136.5)** | (510.0) | (564.6) |
| Issue of securities | **-** | 1,300.0 | 1,705.6 |
| **Net cash flows from financing activities** | **(136.5)** | 780.0 | 1,131.0 |
| | | | |
| **Net increase/(decrease) in cash** | **842.6** | (162.8) | (101.6) |
| Cash and cash equivalents at start of period | **1,876.6** | 1,978.2 | 1,978.2 |
| **Cash and cash equivalents at end of period** | **2,719.2** | 1,815.4 | 1,876.6 |
| | | | |
| **Cash and cash equivalents:** | | | |
| Cash and balances with central banks | **2,602.2** | 1,382.4 | 1,793.6 |
| Due from other banks | **117.0** | 433.0 | 83.0 |
| | **2,719.2** | 1,815.4 | 1,876.6 |

## NOTES TO THE INTERIM FINANCIAL REPORT

### 1 REPORTING PERIOD

These results have been prepared as at 30 June 2013 and show the financial performance for the period from, and including, 1 January 2013 to this date.

### 2 BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES

### BASIS OF PREPARATION

This condensed consolidated financial report for the six months ended 30 June 2013 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with IAS 34 Interim Financial Reporting as adopted by the EU. The Interim Financial Report does not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Annual Report & Accounts for the year ended 31 December 2012, which have been prepared in accordance with IFRS as adopted by the EU.

### CHANGES IN ACCOUNTING POLICY

The accounting policies adopted by the Society in the preparation of its 2013 Interim Financial Report are consistent with those disclosed in the Annual Report & Accounts for the year ended 31 December 2012, except for the adoption of new accounting policies and new standards effective as of 1 January 2013. The new accounting policies adopted are described below.

**Hedge accounting - Cashflow hedges**

During the half year, the Group designated a component of an existing cross-currency swap as a cash flow hedge of the impact of changes in euro-sterling exchange rates on its euro denominated covered bond. This was the first time the Group adopted cash flow hedge accounting. The Group's hedge cash flow hedge accounting policy is as follows:

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity (within the hedging reserve) and reclassified to the income statement in the same period(s) during which the hedged forecast cash flows affect the income statement. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement immediately.

**Accounting standards and interpretations**

Additional accounting standards that became applicable during the interim period did not have a significant impact on the Society's income statement or statement of financial position. The IASB has issued further pronouncements; however, the Society does not expect adoption of any of these pronouncements to have a significant impact on its results. The following standards and amendments, relevant to the Society, have been adopted during the interim period:

| Pronouncement | Nature of change |
|---|---|
| IFRS 13 *Fair Value Measurement* | This standard provides guidance on how fair value should be measured, and sets out the requirements for enhanced disclosures. |
| IAS 1 *Presentation of Financial Statements (Amendment)* | The amendment requires changes to the presentation of the statement of comprehensive income, requiring items that could be reclassified to profit or loss at a future point in time to be presented separately from items that will never be reclassified. |

## NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)

| Pronouncement | Nature of change |
|---|---|
| IAS 19 *Employee Benefits (Amendments)* | The amendments update the recognition, presentation and disclosures of retirement benefit plans, including the elimination of the 'corridor approach' as well as the replacement of the expected return on plan assets and interest cost with a single measurement of net interest income (or expense). This amendment is required to be applied retrospectively.<br><br>The Society had never adopted the corridor approach and in 2012, the expected return on plan assets was equal to the discount factor used for the scheme liabilities. Accordingly there is no impact on the Society's results from adopting these amendments. |

IFRS is subject to ongoing review and endorsement by the EU or possible amendment by interpretive guidance from the International Accounting Standards Board and is therefore subject to change. In addition, practice may develop with regard to interpretation and application of the standards or further standards may be introduced with the option for early adoption. We will update the reporting of future results for any such changes should they occur. The Society's full year Annual Report & Accounts for 2013 may be prepared in accordance with different accounting policies to those used in this document.

## SIGNIFICANT ACCOUNTING JUDGEMENT AND ESTIMATES

The preparation of financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from these estimates. Further details of the critical accounting estimates will be provided in the 2013 Annual Report & Accounts.

### Valuation of derivative financial instruments

In line with the adoption of IFRS 13 *Fair value measurement* and emerging industry best practice, the Society has changed its valuation approach to ensure that derivatives are presented at the value for which they could be transferred in the market. This new approach incorporates the following valuation techniques:

- Cross-currency swaps: the rates used to discount expected future cash flows have been adjusted to incorporate the effect of changes in cross-currency basis spread.
- Interest rate swaps and caps: expected future cash flows have been discounted using the overnight indexed swap (OIS) curve in preference to the LIBOR curve that had been used previously.

The impact of this change in valuation approach resulted in a £4.0 million net gain in respect of cross currency swaps and a £0.1 million gain in respect of interest rate swaps and caps, which have been presented within 'Net gains from derivative financial instruments' within the income statement.

## GOING CONCERN

Details of the Group's objectives, policies and processes for managing its exposure to liquidity, credit, market, operational and business risks are contained in the Risk Management Report of the 2012 Annual Report & Accounts. Taking these objectives, policies and processes into account alongside the current economic and regulatory environment, the directors have concluded that there are no material uncertainties that lead to significant doubt about the Society's ability to continue as a going concern.

The directors confirm they are satisfied the Group has adequate resources to continue in business for the foreseeable future and that therefore, it is appropriate to adopt the going concern basis in preparing this interim financial information.

## NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)

### 3 INTEREST RECEIVABLE AND SIMILAR INCOME

| | **Period to 30 June 2013 (Unaudited) £m** | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|
| On loans fully secured on residential property | **425.0** | 394.8 | 813.3 |
| On other loans | **1.7** | 1.7 | 3.7 |
| | **426.7** | 396.5 | 817.0 |
| Interest and other income on debt securities | **33.1** | 70.7 | 94.2 |
| Interest and other income on other liquid assets | **4.0** | 3.5 | 7.3 |
| Net expense on financial instruments hedging assets | **(39.8)** | (35.3) | (72.0) |
| **Total** | **424.0** | 435.4 | 846.5 |

### 4 INTEREST PAYABLE AND SIMILAR CHARGES

| | **Period to 30 June 2013 (Unaudited) £m** | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|
| Bank and customer | | | |
| Subordinated liabilities | **2.1** | 2.5 | 4.6 |
| Other | **4.3** | 3.7 | 7.3 |
| Debt securities in issue | **71.0** | 88.5 | 148.4 |
| Other borrowed funds | | | |
| On shares held by individuals | **259.9** | 269.0 | 552.0 |
| On other shares | **-** | - | 0.1 |
| On subscribed capital | **6.1** | 6.1 | 12.2 |
| Net income on financial instruments hedging liabilities | **(31.3)** | (32.1) | (65.0) |
| **Total** | **312.1** | 337.7 | 659.6 |

### 5 ADMINISTRATIVE EXPENSES

| | **Period to 30 June 2013 (Unaudited) £m** | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|
| Employee costs | | | |
| Wages and salaries | **24.7** | 21.6 | 46.7 |
| Social security costs | **2.5** | 2.1 | 4.7 |
| Pension costs | | | |
| Defined benefit plan | **0.5** | 1.0 | 2.1 |
| Defined contribution plan | **1.0** | 0.4 | 1.1 |
| | **28.7** | 25.1 | 54.6 |
| Other expenses | **19.6** | 17.2 | 34.4 |
| **Total** | **48.3** | 42.3 | 89.0 |

## NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)

### 6 IMPAIRMENT PROVISIONS ON LOANS AND ADVANCES TO CUSTOMERS

| | **Period to 30 June 2013 (Unaudited) £m** | Period to 30 June 2012 (Unaudited) £m | Year ended 31 December 2012 (Audited) £m |
|---|---|---|---|
| Impairment charge for the period | **3.5** | 4.3 | 9.6 |
| Impairment provision at the end of the period: | | | |
| Loans fully secured on residential property | **20.4** | 19.6 | 20.9 |
| Other loans | **1.6** | 1.5 | 1.6 |
| **Total** | **22.0** | 21.1 | 22.5 |

These provisions are deducted from the appropriate asset values in the balance sheet.

### 7 PROVISIONS FOR LIABILITIES AND CHARGES

| | **30 June 2013 (Unaudited) £m** | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|
| At 1 January | **23.1** | 20.3 | 20.3 |
| Charge for the period | **0.9** | - | 10.2 |
| Provision utilised | **(0.4)** | (0.9) | (7.4) |
| **At 30 June** | **23.6** | 19.4 | 23.1 |

As at 30 June 2013, a provision of £22.1 million (30 June 2012: £18.5 million, 31 December 2012: £22.1 million) was held for amounts payable to the Financial Services Compensation Scheme (FSCS). Revisions to estimates of amounts payable to the FSCS resulted in a £nil charge for the period ended 30 June 2013 (30 June 2012 - £nil charge, 31 December 2012 - £10.2 million charge).

Included above are other provisions totalling £1.5 million (30 June 2012: £0.9 million, 31 December 2012: £1.0 million) made in respect of circumstances that may give rise to various customer claims. During the period, the Society raised a £0.9 million charge (30 June 2012: £nil charge, 31 December 2012 - £0.5 million charge) for Payment Protection Insurance (PPI) redress to customers. It is expected that the liability will mainly crystalise over the next five years.

### 8 DEBT SECURITIES

| | **30 June 2013 (Unaudited) £m** | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|
| Available-for-sale: | | | |
| UK Government investment securities | **1,658.8** | 1,725.3 | 1,597.7 |
| Analysis of transferable debt securities | | | |
| Listed | **479.8** | 598.4 | 589.4 |
| Unlisted | **25.4** | 358.8 | 151.1 |
| **Total** | **2,164.0** | 2,682.5 | 2,338.2 |

## NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)

### 9 LOANS AND ADVANCES TO CUSTOMERS

| | **30 June 2013 (Unaudited) £m** | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|
| Loans fully secured on residential property | **23,104.3** | 20,963.6 | 21,951.1 |
| Other loans | | | |
| Loans fully secured on land | **9.4** | 10.5 | 10.1 |
| Other loans | **58.6** | 61.3 | 57.7 |
| | **68.0** | 71.8 | 67.8 |
| **Total** | **23,172.3** | 21,035.4 | 22,018.9 |

Other loans incorporate £0.7 million (30 June 2012 - £0.8 million, 31 December 2012 - £0.7 million) of loans that are fully secured on residential property and that were made to corporate bodies such as Housing Associations prior to 1 July 1998, the date upon which the Society adopted the powers of the Building Societies Act 1997.

### 10 SHARES

| | **30 June 2013 (Unaudited) £m** | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|
| Held by individuals | **20,924.4** | 19,263.3 | 20,103.0 |
| Other shares | **7.4** | 7.9 | 7.5 |
| Total | **20,931.8** | 19,271.2 | 20,110.5 |

### 11 SUBORDINATED LIABILITIES

| | **30 June 2013 (Unaudited) £m** | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|
| Subordinated liabilities owed to note holders are as follows: | | | |
| Fixed rate subordinated notes 2016 - 12.25% | **7.5** | 7.5 | 7.0 |
| Fixed rate subordinated notes 2021 - 6.12% | **10.1** | 10.1 | 10.1 |
| Fixed rate subordinated notes 2022 - 6.469% | **15.0** | 15.0 | 15.5 |
| Fixed rate subordinated notes 2026 - 6.33% | **10.2** | 10.2 | 10.1 |
| Fixed rate subordinated notes 2032 - 7.54% | **15.3** | 15.3 | 15.4 |
| **Total** | **58.1** | 58.1 | 58.1 |

All subordinated liabilities are denominated in sterling. The notes are repayable at the dates stated, or earlier at the option of the Society, with the prior consent of the Prudential Regulation Authority (PRA).

The rights of repayment of the holders of the notes are subordinated to the claims of all depositors, creditors and shareholders in the Society, as regards the principal of the notes and accrued interest.

**NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)**

## 12 SUBSCRIBED CAPITAL

| | Call date | **30 June 2013 (Unaudited) £m** | 30 June 2012 (Unaudited) £m | 31 December 2012 (Audited) £m |
|---|---|---|---|---|
| Subscribed capital owed to permanent interest holding members is as follows: | | | | |
| Permanent Interest Bearing Shares 1992 - 12 1/8% | n/a | **41.6** | 41.6 | 41.6 |
| Permanent Interest Bearing Shares 2006 - 6.092% | June 2016 | **119.8** | 119.7 | 119.8 |
| **Total** | | **161.4** | 161.3 | 161.4 |

Interest is paid in arrears on £40 million Permanent Interest Bearing Shares at the rate of 12 1/8% per annum in half-yearly instalments, and on £120 million Permanent Interest Bearing Shares at the rate of 6.092% per annum in half-yearly instalments. The shares are repayable only in the event of a winding up of the Society or otherwise with the prior consent of the PRA. In a winding up or dissolution of the Society the claims of the holders of Permanent Interest Bearing Shares would rank behind all other creditors of the Society including subordinated liabilities and the claims of members holding shares as to principal and interest. The holders of Permanent Interest Bearing Shares are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

## 13 AVAILABLE-FOR-SALE RESERVE

Amounts within the Available-for-sale reserve are transferred to the income statement upon the disposal of debt securities, and where a hedging relationship exists between the debt securities and a derivative instrument.

During the period, £76.2 million loss (30 June 2012 - £14.2 million gain, 31 December 2012 - £26.1 million gain) was transferred to 'Net gains from derivative financial instruments' in the income statement in respect of hedge accounting adjustments to offset the effects of changes in the fair value of derivatives hedging Available-for-sale debt securities. Amounts transferred to 'Interest receivable and similar income' totalled £2.9 million gain (30 June 2012 - £13.9 million gain, 31 December 2012 - £15.1 million gain) in respect of the disposal of Available-for-sale debt securities.

## 14 HEDGING RESERVE

*Cash flow hedges for currency risks*

During the period, the Group designated a component of an existing cross-currency swap as a cash flow hedge of the impact of changes in euro-sterling exchange rates on its euro denominated covered bond. This hedge is assessed to be highly effective.

During the period, £1.7 million (30 June 2012 - £nil, 31 December 2012 - £nil) was transferred to the hedging reserve in respect of cash flow hedge accounting. Amounts transferred to 'Total income' in the income statement totalled £1.2 million (30 June 2012 - £nil, 31 December 2012 - £nil) in respect of movements in the hedged item that affect the income statement.

**NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)**

## 15 FINANCIAL INSTRUMENTS

Set out below is a comparison by category of the carrying amounts and the fair values of all the Group's non-derivative financial instruments:

| | **Carrying amount 30 June 2013 (Unaudited) £m** | **Fair value 30 June 2013 (Unaudited) £m** | Carrying amount 31 December 2012 (Audited) £m | Fair value 31 December 2012 (Audited) £m |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash | **2,639.6** | **2,639.6** | 1,814.2 | 1,814.2 |
| Debt securities – Available-for-sale: | | | | |
| UK Government investment securities | **1,658.8** | **1,658.8** | 1,597.7 | 1,597.7 |
| Analysis of transferable debt securities | | | | |
| Listed | **479.8** | **479.8** | 589.4 | 589.4 |
| Unlisted | **25.4** | **25.4** | 151.1 | 151.1 |
| **Total** | **2,164.0** | **2,164.0** | 2,338.2 | 2,338.2 |
| | | | | |
| Loans and advances at amortised cost: | | | | |
| Loans and advances to credit institutions | **339.8** | **339.8** | 323.7 | 323.7 |
| Loans and advances to customers | **23,172.3** | **22,817.6** | 22,018.9 | 21,710.8 |
| **Total** | **23,512.1** | **23,157.4** | 22,342.6 | 22,034.5 |
| | | | | |
| **Financial liabilities** | | | | |
| Financial liabilities at amortised cost: | | | | |
| Shares | **20,931.8** | **21,230.1** | 20,110.5 | 20,140.7 |
| Deposits, amounts owed to customers and debt securities | **6,139.8** | **6,363.1** | 5,050.1 | 5,369.7 |
| Subordinated liabilities | **58.1** | **59.6** | 58.1 | 61.3 |
| Permanent Interest Bearing Shares | **161.4** | **172.9** | 161.4 | 181.1 |
| **Total** | **27,291.1** | **27,825.7** | 25,380.1 | 25,752.8 |

*Loans and advances to customers*
The fair value of loans to customers is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting estimated future cash flows are discounted at current market rates to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

*Customer shares and deposits*
Shares and deposits from customers are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of shares and deposits that are available on demand is the amount repayable on demand. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows from those deposits discounted at the current market rates for those types of deposit.

**Valuation of Financial Instruments**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted prices (unadjusted) in active markets for identical instruments.
- Level 2: valuation techniques for which all significant inputs are based on observable market date.
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

**NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)**

## 15 FINANCIAL INSTRUMENTS (CONTINUED)

When applicable, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For all other financial instruments the Group determines fair values using other valuation techniques. The Group uses widely recognised valuation models for determining the fair value of more common and simple financial instruments, like interest rate swaps and caps and currency swaps. Observable model inputs for the valuation of these instruments are readily available in the market. The availability of observable model inputs reduces the need for management judgement and estimation, and also reduces the uncertainty associated with the determination of fair values.

### Fair Value Measurements and Classification within the Fair Value Hierarchy

The classification in the fair value hierarchy of the Group's financial instruments measured at fair value is summarised in the table below. The narrative that follows describes the significant valuation inputs and assumptions for each class of instrument measured at fair value.

| 30 June 2013 | Level 1 £m | Level 2 £m | Level 3 £m | Total fair value £m |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Derivative financial instruments | | | | |
| Interest rate swaps | **-** | **201.4** | **-** | **201.4** |
| Interest rate floors | **-** | **21.0** | **-** | **21.0** |
| **Total** | **-** | **222.4** | **-** | **222.4** |
| | | | | |
| Debt securities - Available-for-sale: | | | | |
| UK Government investment securities | **1,658.8** | **-** | **-** | **1,658.8** |
| Analysis of transferable debt securities | | | | |
| Listed | **479.8** | **-** | **-** | **479.8** |
| Unlisted | **-** | **25.4** | **-** | **25.4** |
| **Total** | **2,138.6** | **25.4** | **-** | **2,164.0** |
| | | | | |
| **Financial liabilities** | | | | |
| Derivative financial instruments | | | | |
| Interest rate swaps | **-** | **228.0** | **35.7** | **263.7** |
| Currency swaps | **-** | **5.8** | **-** | **5.8** |
| **Total** | **-** | **233.8** | **35.7** | **269.5** |

There have been no transfers between any of the levels during the period. Transfers only occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure.

*Level 1 - Debt securities - Available-for-sale - Listed*

Market prices have been used to determine the fair value of listed debt securities.

*Level 2 - Derivatives*

Derivative products valued using a valuation technique with observable market inputs are interest rate swaps, interest rate caps and cross currency swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various inputs, including interest rate curves and foreign exchange spot and forward rates, which are readily available in the market.

## NOTES TO THE INTERIM FINANCIAL REPORT (CONTINUED)

### 15 FINANCIAL INSTRUMENTS (CONTINUED)

*Level 2 - Available-for-sale – Unlisted*

Debt securities valued using a valuation technique with observable market inputs are certificates of deposits. The valuation techniques applied are models using present value calculations. The models incorporate various inputs including interest rate curves, which are readily available in the market. As the unlisted debt securities related to highly rated counterparties and with a typical maturity period of less than 30 days, counterparty credit risk is considered to be negligible when calculating the fair value of unlisted Available-for-sale debt securities.

*Level 3 - Derivatives*

Wherever possible, derivative products are valued using methods classified as either level 1 or level 2 in the valuation hierarchy. The derivative products valued using a valuation technique with unobservable market inputs (level 3) are interest rate swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions, including interest rate curves, which are observable and unobservable inputs relating to the projected principal and expected life of the swap. The valuations applied were obtained from external parties without adjustment, and are not developed by the Society.

The items included within level 3 are balance tracking swaps, for which the unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. The projection of the balance on the underlying mortgage portfolio is dependent on the interest rates on the products within the portfolio, published mortality tables and assumptions as to pre-payment rates, which are themselves partly dependent on interest rate expectations.

*Reconciliation of recurring fair value measurements categorised within level 3 of the fair value hierarchy*

| | Total £m |
|---|---|
| **As at 1 January 2013** | **(46.3)** |
| Income statement | |
| Interest payable and similar expense | **(3.2)** |
| Net unrealised gains from derivative financial instruments | **10.6** |
| Settlements | **3.2** |
| **As at 30 June 2013** | **(35.7)** |

### 16 RELATED PARTY TRANSACTIONS

Full details of the Group's related party transactions for the year to 31 December 2012 can be found in note 44 of the 2012 Annual Report & Accounts. The Group had no significant related party transactions outside the normal course of the business during the period to 30 June 2013.

**RESPONSIBILITY STATEMENT**

The directors confirm that this Interim Financial Report has been prepared in accordance with IAS 34 as adopted by the EU. The half year management report includes a fair review of the important events that have occurred during the first six months of the financial year and their impact on the Interim Financial Statements, as required by the Disclosure and Transparency Rules (DTR 4.2.7). The principal risks and uncertainties affecting the Society are reported on page 7 of the Interim Financial Report in addition to those reported within the Risk Management Report starting on page 25 of the Annual Report & Accounts as at 31 December 2012. These risks continue to affect the Society as at 30 June 2013.

A full list of the Board of directors can be found in the 2012 Annual Report & Accounts, with the following amendments during the period to 30 June 2013:

- David Harding retired as Chairman on 31 December 2012 and Ian Pickering was appointed as Chairman on 1 January 2013.
- Feike Brouwers was appointed as Chief Risk Officer on 1 April 2013 and as executive director with effect from 24 April 2013.
- Brona McKeown was appointed as the Society's Interim General Counsel and Secretary on 10 April 2013 following the resignation of Gill Davidson, the Society's General Counsel and Secretary, on 9 April 2013.
- Fiona Smith retired from the Board as a non-executive director at the Annual General Meeting held on 25 April 2013.
- Peter Ayliffe was appointed to the Board as a non-executive director on 1 May 2013.

Signed on behalf of the Board by

| | |
|---|---|
| David Stewart | John Lowe |
| Chief Executive | Finance Director |

1 August 2013

**INDEPENDENT REVIEW REPORT TO COVENTRY BUILDING SOCIETY**

**Introduction**

We have been engaged by the Society to review the set of condensed consolidated financial statements in the Interim Financial Report for the six months ended 30 June 2013 which comprises the Condensed Consolidated Income Statement, Condensed Consolidated Statement of Comprehensive Income, Condensed Consolidated Statement of Financial Position, Condensed Consolidated Statement of Changes in Members' Interests, Condensed Consolidated Statement of Cash Flows and the related explanatory notes 1 to 16. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Society in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society, for our work, for this report, or for the conclusions we have formed.

**Directors' Responsibilities**

The Interim Financial Report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Financial Report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2, the Annual Report & Accounts of the Society are prepared in accordance with IFRSs as adopted by the European Union. The set of condensed consolidated financial statements included in this Interim Financial Report has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

**Our Responsibility**

Our responsibility is to express to the Society a conclusion on the set of condensed consolidated financial statements in the Interim Financial Report based on our review.

**Scope of Review**

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the set of condensed consolidated financial statements in the Interim Financial Report for the six months ended 30 June 2013 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Ernst & Young LLP
London
1 August 2013

**OTHER INFORMATION**

The Interim Financial Report information set out in this document is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986.

The financial information for the year ended 31 December 2012 has been extracted from the Annual Accounts for that year. The Annual Accounts for the year ended 31 December 2012 have been filed with the Financial Conduct Authority (formerly the Financial Services Authority). The Auditors' report on these Annual Accounts was unqualified.

A copy of the Interim Financial Report is placed on the website of Coventry Building Society. The directors are responsible for the maintenance and integrity of the information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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